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Nos. 403, 404.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1935.

GEORGE ASHWANDER *et al.*,
Petitioners,

against

TENNESSEE VALLEY AUTHORITY *et al.*,
Respondents.

On Petition for Writs of Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit.

MEMORANDUM FOR RESPONDENT THE CHEMICAL BANK & TRUST COMPANY.

COURTLAND PALMER,
JEHU T. STOKELY,
Solicitors.

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On Petition for Writs of Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit.

MEMORANDUM FOR RESPONDENT THE CHEMICAL BANK & TRUST COMPANY.

The Tennessee Valley Authority does not object to the granting of a writ in No. 403 (p. 12, TVA brief), but does object to the granting of a writ in No. 404, which prayed for a declaratory judgment that the Tennessee Valley Authority Act and the proposed program thereunder are unconstitutional.

This memorandum is limited to this latter phase, to show that a writ in No. 404 is plainly in the public interest, as it involves one of the most important controversies now pending in the courts.

I.

The Chemical Bank & Trust Company was made a defendant, as it is trustee under the general mortgage of the Alabama Power Company, pledging all its property within the State of Alabama to secure $70,000,000 of bonds in the hands of the public.

A release by the said trustee was requisite to consummate the sale of the transmission lines of the Power Company, covered by the contract of January 4, 1934, to TVA for its utility system (R. p. 322 *et seq.*). The trustee refused to grant the release, as the consideration proposed to be paid for the property was inadequate, i. e., about $2,890,000 less than the fair value of the property and transmission lines proposed to be conveyed, and as the statute authorizing the creation of the TVA and the objects proposed to be accomplished thereby were unconstitutional.

The contract, and the acts proposed under it, would have had the effect of drying up the Alabama Power Company's franchises, licenses, business and system in five entire and two fractional counties in northeast Alabama, by splitting off the transmission lines and sources of power serving seventeen urban distribution systems, and about 10,000, or one-tenth, of the company's customers (Finding No. 14, R. II, p. 1038).

Since this initial contract plainly worked an immediate mutilation of the Power Company's system and the policy set forth in the statute, the contract of August 9, 1934, together with overt acts, showed a purpose on the part of the Tennessee Valley Authority to take other parts of the property and system of the Alabama Power Company at inadequate and forced prices; and thus endanger the value of the stockholders' equity and the security of these mortgagees (R. p. 1032), all in furtherance of a stated purpose on part of TVA to use the property for the operation of a commercial electric distribution system within the State, stated by it to be the dominant objective of the program

(Findings Nos. 26, 27, 28, R. II, p. 1042; Finding No. 70, R. II, p. 1059); it is regarded by us as clear that the stockholders had the right to protest and upon due compliance with Equity Rule 27 to file suit (Finding No. 18, R. II, p. 1039; Conclusion No. 23, R. II, p. 1099). And certainly this respondent, to protect the security afforded by the mortgages, threatened with loss, had the duty to join with the plaintiff in asking the protection of the court to declare the statute and the program instituted thereunder illegal and unconstitutional (Answer, R. pp. 329-332).

Hill v. *Wallace*, 259 U. S. 44.
Dodge v. *Woolsey*, 18 How. 331.
Chicago v. *Mills*, 204 U. S. 321.
D. & H. Co. v. *Albany etc. Co.*, 213 U. S. 435.
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Cotting v. *Kansas City*, 183 U. S. 79.
Smith v. *Kansas City etc. Co.*, 255 U. S. 180.
Brushaber v. *Union Pacific*, 240 U. S. 1.

A contract for purchase of property intended to be used in violation of the Ninth and Tenth Amendments is plainly contrary to public policy. The known purpose, stated in the contract itself, cannot be stripped from the contract.

Central Trans. Co. v. *Pullman Co.*, 139 U. S. 24.
Thomas v. *Railroad Co.*, 101 U. S. 71.

Obviously a contract of sale calculated and intended by the purchaser to be used directly and permanently to further a violation of the Constitution and known to be for that purpose is illegal and *ultra vires* as to both parties.

As stated in *Central Transportation Co.* v. *Pullman Co.*, *supra:*

> "In the case before the Court, of a contract forbidden by public policy and beyond the power of

defendant corporation, it was its legal duty, a duty *both to its stockholders and to the public,* to rescind and abandon the contract at the earliest moment. * * *"

Citing:

Thomas v. *Railroad Co.*, 101 U. S. 71.

II.

The Power Company was and is confronted not merely with the severing of the transmission lines serving its seventeen urban distribution systems, but with TVA competitive duplication of its entire system by aid of PWA loans, plainly threatening the entire value of its properties and the certain loss of its franchises and business.

The phase of the record appurtenant to the above heading plainly calls for decretal relief broader than the mere annulment of the contract of January 4, 1934. The appeal in No. 404 pointed out the respects in which the decree of the District Court did not adequately adjudicate the judicial controversy actually involved.

Thus, the proof showed that in furthering TVA competition in the seventeen urban distribution areas, TVA reserved to itself a variety of alternatives. When the contract of January 4, 1934, was entered into taking over the transmission systems, that undermined the distribution systems, but did not dispose of them.

The first gesture was to threaten the Power Company with duplication of distribution system by the use of PWA loans (see telegram of Lilienthal to Willkie, R. II, pp. 515-516), thus forcing the option agreement of August 9, 1934, as agreed in the telegram of June 28, 1934 (R. II, p. 516) (Findings Nos. 7, 9, 13, pp. 1036-1038).

The second was to cancel the option agreement of August 9th before trial and final decree and resume the construction of competitive systems through PWA loans and 30% grants supported by contracts for TVA power, to be distributed subject to the control and regulation of TVA.

The third phase, plainly within the scope of the original Act and the *carte blanche* spending power of the Act, is emphasized by the recent amendment to the Tennessee Valley Authority Act, approved August 31, 1935 (Act Public No. 412, 74th Congress, H. R. 8632). Section 9 of the amendment adds a new section (15-a) of the Act, printed herewith as an appendix), which gives to TVA the power to issue $50,000,000 of United States bonds, in order to extend credit to (that is, finance) municipalities and non-profit organizations in acquiring, improving, operating and interconnecting existing facilities for the distribution of TVA electricity. Thus taking away from the Alabama Power Company its property, franchises and business.

It is obvious that the bill of complaint as originally filed, the prayer, the issues tendered by the amendment to the bill and the necessary scope of the relief, reasonably call for elasticity in the decree to meet the shifting phases of TVA competition in the existing and threatened phases of its utility operations.

The trustee, charged with responsibility under the mortgages for the preservation of the mortgage security, conceived that the inadequacy of the consideration tendered by TVA was proper to be considered. The District Court thought not (R. II, p. 1033), and evidence to that effect was not received. The record on that point is, indeed, adequate, since, for some reason, the parties themselves stipulated in the exhibits to the contract of January 4, 1934 (R. I, p. 152), that the replacement value of the items were amounts which, on comparison with the contract price, are found to be practically double the prices proposed (R. p. 1032). The court excluded all question of adequacy of consideration on the theory that the contract being in furtherance of proposed illegal operations by TVA of a utility system, made immaterial any other ground of inadequacy resulting from business compulsion or administrative malevolence (*American Trust Co.* v. *Federal Reserve Bank*, 256 U. S. 350). With that conclusion *on that premise* there can be no quarrel, but to limit the decree practically to the bare annulment

of the contract of January 4, 1934, when the record shows that the Power Company property as a whole was menaced, and, indeed the entire system of the Power Company subject to the mortgages, is plainly not a full and adequate decision of the basic controversy clearly justiciable and presented on this record.

III.

The issue in controversy is the lawful authority of TVA under the statute* to engage in the business of commercial manufacture of electricity for non-federal purposes by means of a utility system for the dominant objective of promoting public ownership and regulating local rates.

That issue in controversy cannot be fairly disposed of on this complete record by a decree related merely to the contract of January 4, 1934.

Hence the appeal by the plaintiffs from the decree in their favor (R. p. 1278 *et seq.*). See appropriate assignment of errors by the plaintiff-cross-appellants (p. 1295), pointing out, and in our opinion correctly, the respects in which the final decree of March 2, 1935, adjudicating the constitutional invalidity of the TVA program and the related contract of January 4, 1934, did not settle the entire controversy.

The District Court plainly recognized that supplemental relief would be necessary.

> "(27) This Court has, in the view taken of the relief to which plaintiffs are entitled, given no consideration to the request or prayer of plaintiffs for a declaratory judgment or to any phase or matter of relief not reflected in the final decree herein and in these conclusions of law and is without prejudice to such further independent or supplemental relief as may hereafter be sought by plaintiffs or by the Alabama Power Company in its own right" (Conclusion of Law No. 27, R. p. 1101).

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* Tennessee Valley Authority Act of 1933, May 18, 1933, C. 32; 48 Stat. 58.

The case appears clearly one for declaratory relief under the Act of June 14, 1934 (Act Public No. 343, 73rd Congress, 28 U. S. C. A., Sec. 400; *Nashville, C. & St. L. R. Co.* v. *Wallace,* 288 U. S. 249; *United States* v. *West Virginia,* October Term, 1934).

It is respectfully submitted that the practice of this Court as exemplified in *Penna. Coal Co.* v. *Mahon,* 260 U. S. 393, at p. 414, calls for broad consideration on this record. The program of the Tennessee Valley Authority is a manifest and admitted program for collectivist operation of a power system as a precedent for like action throughout the United States. The defense that it is merely and rationally the innocent disposal of surplus manufacturing capacity created in *bona fide* exertion of the war power or the improvement of navigation is not sustained by the record and is expressly repudiated by the findings. The consideration of the record should not be restricted by denial of the writ in No. 404.

The memorandum of the Tennessee Valley Authority is significant in that, as in the court below, there is no defense of the proposed commercial operation of the steam-electric plants aside from the supposed right to install and operate commercial electric plants in navigation dams.

There is no relationship between the high power steam plant constructed at Muscle Shoals for the manufacture of munitions of war *and other useful commodities* (Sec. 124, National Defense Act of 1916, 39 Stat. 215), and the necessary commercial electric generators installed in navigation dams. Regulation of navigation under the Commerce Clause lends no ostensible support whatever for a critical question on the record, viz., the authority of Congress to utilize plants justified, if at all, only under the war power for commercial operations, as a basis for an electric utility system, the objective of which is to promote competitive public ownership or regulate rates by federal competition (Lilienthal, R. p. 624).

Yet the navigation argument is all that appears to be advanced in support of the commercial operation of the

40,000 kilowatt steam-electric plant at Muscle Shoals, capable of producing 350,000,000 kilowatt hours of electric energy annually or the commercial operation of the steam plants at Tupelo and Amory purchased by TVA as part of its north Mississippi utility system.

It is respectfully submitted that the mystery of water power and the catch-word of waste of natural resources is being stretched beyond constitutional limits to cover a plain case of commercial manufacture both inland and on the Tennessee River.

As to navigation alone, it seems demonstrable on this record that the position of TVA is not well taken.

The settled decisions of this Court are opposed to the contention of the Tennessee Valley Authority and the conclusion of the Circuit Court of Appeals, to the effect that the Federal Government acquires a proprietary right in the waters or in the use of waters impounded by navigation dams.

Pollard's Lessees v. *Hagan*, 3 How. 212.

Shively v. *Bowlby*, 152 U. S. 1.

Port of Seattle v. *Oregon-Washington Ry.*, 255 U. S. 56.

United States v. *Arizona*, 79 L. Ed. Adv. Op. 681, 685, 55 Sup. Ct. 666.

United States v. *West Virginia*, 79 L. Ed. Adv. Op. 848.

Kansas v. *Colorado*, 206 U. S. 89.

IV.

Without reference to the absence of any proprietary right of the United States in surplus waters, the program of commercial operation of a war purpose steam plant as a basis for a general proprietary business in State domain in competition with the State and its citizens is in violation of the Tenth Amendment.

The respondent Tennessee Valley Authority states in its brief (p. 19) that "the Authority's presently proposed activities in the territory of the Alabama Power Company are limited by the terms of the contract before this court"; and (p. 14) "there is no evidence that the use of these steam plants is proposed in connection with the transmission lines here involved."

These are not correct statements of fact, as will be seen from the Findings of Fact Nos. 14, 19 (pp. 1038, 1039), 27 (p. 1042), 32 (p. 1045), and steam plants, No. 53 (p. 1050).

The States and all citizens are directly interested in that phase of the record in this proceeding not dealt with by the Circuit Court of Appeals, viz., the use of the Muscle Shoals steam plant as a source of power for a region-wide utility transmission and distribution system.

In short, whether the Government owns coal or oil or buys or, as in the case of the surplus waters not necessary for navigation, appropriates it without right, there is no lawful right in the Government to process this source of energy into a marketable commodity for sale by the Government for profit or to accomplish the non-federal legislative, economic or political objectives which constitute the dominant and decisive purpose of the Tennessee Valley Authority program.

There is a radical distinction between the regulation of navigation and the process of commercial manufacture and transmission of electricity.

The decision of this Court in *Utah Power & Light Co.* v. *Pfost*, 286 U. S. 165, clearly establishes the distinction between the raw material (coal or falling water) utilized as the basis for the manufacture of electricity, the commodity resulting from that manufacturing process, and the subsequent act of transmission. The opinion of the Circuit Court of Appeals does not give effect to these distinctions. The function asserted by the Tennessee Valley Authority within State domain is in its entirety proprietary and non-governmental.

In *Twin Falls Canal Co.* v. *Foote*, 192 Fed. 583, 494, the court said:

> "In prosecuting such an enterprise (reclamation project), however, it (the United States) is not primarily performing a governmental, or, strictly speaking, even a public function, but is promoting its proprietary interests. Such advantage as arises therefrom to the people at large is material and not governmental, and is only such as might indirectly accrue to the public from the reclamation of an equal amount of land through private enterprises. Kansas v. Colorado, 206 U. S. 46, 92, 27 Sup. Ct. 655, 51 L. Ed. 959; United States v. Hanson, 167 Fed. 881, 93 C. C. A. 371; United States v. Burley, 172 Fed. 615, Id. 179 Fed. 1, 102 C. C. A. 429."

The functions are as clearly commercial and proprietary on part of the United States as were the functions considered in the State business cases from the standpoint of federal taxation.

South Carolina v. *United States*, 199 U. S. 437.
Ohio v. *Helvering*, 292 U. S. 360.
Helvering v. *Powers*, 79 L. Ed. Adv. Op. 141.

The proprietary function of commercial transmission and distribution within State domain having by express finding

of the District Court no relation whatever to war or any federal function, are plainly beyond the lawful scope of the Federal Government.

That the inevitable and necessary effect of this program of encroaching upon the functions of the State is to dry up the commerce of its citizens and its revenues by withdrawing them from *ad valorem* and excise taxation is obvious.

The program involves the breakdown of the powers reserved under the Tenth Amendment.

If the rights asserted on behalf of the Government by TVA, and sustained by the Circuit Court of Appeals on this record, should be affirmed by the denial of the writs in this cause, then the question whether and to what extent the Federal Government will, under the guise of preparedness for war or overbuilding war plants or navigation improvements, enter into commercial operations in State domain, is left to the discretion of Congress and is no longer protected by the Tenth Amendment. According to the conclusion announced by the Circuit Court of Appeals, any rational means adopted by Congress to provide a market for electricity produced for commercial purposes is within the discretion of Congress. In short, the Government of the United States may not only manufacture electricity for commercial sale at steam-electric or hydro-electric plants, not only may it transmit that electricity throughout State domain and sell it either at wholesale or retail, but it would logically follow that, as plainly inherent in the reserved plans of the Tennessee Valley Authority, if customers of the power could not otherwise be obtained after driving the State and its citizens out of the market, the Government could subsidize, operate or control any manufacturing plant whatever in order to create a market for its power by analogy to the decisions of this Court which have authorized the creation of fiscal corporations to provide a market for federal securities.

To say that the Authority's activities in the territory of the Alabama Power Company are limited by the terms of the contract before the Court (p. 19, TVA brief) is attempting to limit a great national question crying for solution and closing one's eyes to the statute and the overt acts of the TVA shown in the record.

In short, this record presents the complete and final breakdown of the Tenth Amendment. It will be a casus of the first magnitude if the decision of the Circuit Court of Appeals, plainly sustaining any such consequence, should not be reviewed and reversed.

Respectfully submitted,

COURTLAND PALMER,
JEHU T. STOKELY,
Solicitors.

October 2, 1935.

APPENDIX.

[PUBLIC—No. 412—74TH CONGRESS]
[H. R. 8632]

SEC. 9. That said Act be and the same is hereby further amended by adding after section 15 of said Act a new section as follows:

"SEC. 15a. With the approval of the Secretary of the Treasury, the Corporation is authorized to issue bonds not to exceed in the aggregate $50,000,000 outstanding at any one time, which bonds may be sold by the Corporation to obtain funds to carry out the provisions of section 7 of this amendatory Act. Such bonds shall be in such forms and denominations, shall mature within such periods not more than fifty years from the date of their issue, may be redeemable at the option of the Corporation before maturity in such manner as may be stipulated therein, shall bear such rates of interest not exceeding 3½ per centum per annum, shall be subject to such terms and conditions, shall be issued in such manner and amount, and sold at such prices, as may be prescribed by the Corporation, with the approval of the Secretary of the Treasury: *Provided,* That such bonds shall not be sold at such prices or on such terms as to afford an investment yield to the holders in excess of 3½ per centum per annum. Such bonds shall be fully and unconditionally guaranteed both as to interest and principal by the United States, and such guaranty shall be expressed on the face thereof, and such bonds shall be lawful investments, and may be accepted as security, for all fiduciary, trust, and public funds, the investment or deposit of which shall be under the authority or control of the United States or any officer or officers thereof. In the event that the Corporation should not pay upon demand, when due, the principal of, or interest on, such bonds, the Secretary of the Treasury shall pay to the holder the amount thereof, which is hereby au-

thorized to be appropriated out of any moneys in the Treasury not otherwise appropriated, and thereupon to the extent of the amount so paid the Secretary of the Treasury shall succeed to all the rights of the holders of such bonds. The Secretary of the Treasury, in his discretion, is authorized to purchase any bonds issued hereunder, and for such purpose the Secretary of the Treasury is authorized to use as a public-debt transaction the proceeds from the sale of any securities hereafter issued under the Second Liberty Bond Act, as amended, and the purposes for which securities may be issued under such Act, as amended, are extended to include any purchases of the Corporation's bonds hereunder. The Secretary of the Treasury may, at any time, sell any of the bonds of the Corporation acquired by him under this section. All redemptions, purchases, and sales by the Secretary of the Treasury of the bonds of the Corporation shall be treated as public-debt transactions of the United States. With the approval of the Secretary of the Treasury, the Corporation shall have power to purchase such bonds in the open market at any time and at any price. No bonds shall be issued hereunder to provide funds or bonds necessary for the performance of any proposed contract negotiated by the Corporation under the authority of section 7 of this amendatory Act until the proposed contract shall have been submitted to and approved by the Federal Power Commission. When any such proposed contract shall have been submitted to the said Commission, the matter shall be given precedence and shall be in every way expedited and the Commission's determination of the matter shall be final. The authority of the Corporation to issue bonds hereunder shall expire at the end of five years from the date when this section as amended herein becomes law, except that such bonds may be issued at any time after the expiration of said period to provide bonds or funds necessary for the performance of any contract entered into by the Corporation, prior to the expiration of said period, under the authority of section 7 of this amendatory Act."